



Business & Economie

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Summary

In August, the main evolutions of the regulatory framework were the adoption of Law on Savings and Credit Associations (SCA), Law on limited liability companies, and the Law on auditing. The first law liberalizes the framework for functioning of the Savings and Credit Associations. As a result, these associations could be constituted not only by citizens, but by juridical entities too, while their territorial borders of functioning will become less rigid. Regarding the new Law on limited liability companies, the Parliament did not change the minimal threshold of 5400 lei for the normative capital. By refraining from adopting the initially proposed new threshold of 30 thousands lei, the parliamentarians avoided a gaffe with major social and economic consequences. One of the main provisions of the Law on auditing is that public interest entities ought to audit their financial reports mandatory. Although apparently minor, this provision will trigger significant changes in the public economy sector, where many companies, that do not want to be publicly exposed, will have to reduce their scale of activity under the minimal threshold established for an economic agent to be considered as a public interest entity.

The **industrial** output resumed its growth in real terms. In January-July, its value was by 0.5% higher than in 2006. However, in order to recover the 2005 output level, the industrial sector should grow by almost 7.5% in 2007 that is a hard-reaching aim. The greatest hindrances are the winemaking and alcoholic drinks branches, which have a production by 4, and respectively, 3 times lower than in January-July 2006. The drought that compromised the 2007 harvest had a set of consequences, sometimes paradoxical, for some of the food industry branches. For instance, the meat industry was favored by drought; due to financial problems, the producers from the livestock sector were imposed to massively slaughter the livestock. Nevertheless, the production of dairy products, canned fruits and vegetables, and tobacco products suffers from a raw material deficit.

In August the **agriculture** born huge losses, accompanied by rise in prices for food and new difficulties for producers and authorities to settle the crisis. On this background, the international community started to provide financial and material aid. At the same time, the authorities are looking for long-term mechanisms that will allow them to avoid hereafter the high-gravity consequences resulted after similar droughts.

The evolution of the **services sector** is characterized by a dynamic development of the telecommunication services, especially the mobile telephony, the advertisement and insurance services, as well as the goods and passengers transportation, and touristic services (mainly, the abroad-oriented tourism). The services rendered to the population have registered a more reduced pace of development.

In August, in the **budgetary sphere**, it is noteworthy the publication of the Decision on approving the Report on management of public finances in the budgetary year 2006. The revenues of the state budget, of the compulsory medical insurance fund and local budgets were executed at more than 100%. At the same time, the expenditures were executed under the planned level. This tendency persisted in January-August 2007 too. As a result, was suspended the access to the means unused by the state budget executors, excepting the means for capital investments and capital repairs. The reducing number of taxpayers to compulsory social and medical insurance funds along with the increasing pace of the population aging jeopardizes the public social insurance system. The Ministry of Finance brought in the draft 2008 State Budget Law to the Government, with revenues of 14458.0 million lei and expenditures of 14681.7 million lei. There are some differences between the macroeconomic indicators estimated for 2008 in the Medium Term Expenditure Framework for 2008-2010 (MTEF) and the draft of the State Budget Law. According to the Report on implementation of the Law on economy liberalization, presented by the minister of Economy and Trade, the State Tax Service annulled the arrears to the state budget of 32,065 taxpayers or, a quantum of 3.992 billion lei since the law enactment until August. At the same time, the capital and financial means legalization proceed slower; for the moment the first cases of assets legalization have been registered. The total value of assets exceeded 7 million lei.

In August, the **prices** continued to rise even faster than in July. Thus, in August the inflation rate reached 2.2%, the highest monthly inflation in 2007. This happened due to the prices rise for services rendered to the population by 5.2%, stemming from the increased tariffs on energy since August 3, 2007. The food prices also rose by 2.2% in August, and hit their highest level of 2007.

On the **labour market**, the nominal salaries continued to rise, along with prices for food and energetic agents. At the same time, the shortage of the qualified staff is deepening, mainly due to the emigration and the low-quality training provided by the universities.

The **monetary policy** did not basically change in August. At the same time, the National Bank of Moldova (NBM) made public a press release that reveals the NBM concerns regarding the evolution of inflation. This fact let us suppose that in the near future an increase of the NBM rate is likely. The official reserve assets surpassed the psychological threshold of 1 billion USD in August. The official reserve assets accumulation has also progressed in the relative terms; at the present time the official reserve assets cover more than 3 months of imports.

In the **banking system**, in July the commercial banks decreased the average interest rates on credits offered in both national and foreign currency, reaching 18.82% and 10.81%, respectively. The amount of credits granted in July reached the highest record in 2007. At the same time, the interest rate on deposits given in national and foreign currency climbed to 15.50% and 6.05% respectively. Unfortunately, we can not expect this trend to continue because of high inflation rate scored at the beginning of the second semester. The ongoing increase of foreign investors' share in the Moldovan banks' capital is likely due to the Petromservice S.A intent to purchase shares of a Moldovan bank, and the Eximbank decision to increase its normative capital by 250 million lei.

On the **financial markets**, the interest rate on T-Bonds declined in August. Considering the ascending inflation, we could expect the decline of bonds' profitability in the near future; hence, the commercial banks will be less interested to invest in state bonds. An important evolution is the Moldovan leu appreciation against the US dollar caused by intensified remittances from emigrants (including from Russian Federation, where the salaries paid in constructions are rising), higher foreign investments and greater inflow of bi- and multilateral official aid. The evolutions on regional and global financial markets have also influenced the exchange rate in Moldova.

In January-July 2007, Moldova's **foreign trade** was marked by the trade deficit increasing up to 1.2 billion lei. The widening of the trade deficit stems from an already „traditional" trend for Moldova; namely the dramatic boost of imports in condition of rather modest increase of exports. At the same time, Moldovan exports are still based on low added value products that face the harshest competitive pressures on the sales markets. The resumption of Moldovan wine exports to Russian market remains uncertain; but this issue was a subject of an exchange of though replies between both parts.

During August, the **oil** price for Brent brand showed controversial evolutions, varying between 70-75 USD/barrel. The lowering price trend was determined by the controversial economic situation in Unites States, the main global oil consumer, while the rising price trend – by bad weather conditions in the Gulf of Mexico and the reduction in reserves of oil derivatives in the United States. An eventual deceleration of the global economic growth would reduce the oil prices.

The forecasts for **wheat** crop 07/08 continue to be negatively affected by unfavorable weather conditions in the northern hemisphere and Australia. Eventual restrictions on the wheat exports from Russia will reduce even more the wheat supply, when the global stocks reached the historical lows from 1979-80 onwards.

In August the **dollar-euro** exchange rate was profoundly affected by turbulences on the global financial markets. The dollar strengthened on the peak of these turbulences, as the “nervous” investors perceived it as the surest refuge. However, by the end of August, because of the deepening crisis on American real estate market and the optimistic statistical data on the evolution of European economy, the dollar depreciated against the euro again.

The **Russian** economy continued its ascending trend, growing in January-July 2007 by 7.9% as compared to the similar period of 2006. The driving factors are the demand for investments, constructions sector and industry. At the same time, considering the high exposure level of Russian banks and corporative sector to the foreign credits, the escalation of turbulences on the global markets could negatively affect the Russian economy prospects.

The **Ukrainian** economy continued to grow too, due to the expansion of private consumption and exports. The growth in exports was supported by favorable circumstances on the metal market, high demand for machinery and equipment made in Ukraine, and by commercialization of Ukrainian agricultural products. At the same time, the restrictions on grain exports (set up on July 1st) will moderate the exports' growth. Moreover, an eventual deceleration of the global growth would have a negative impact on the metals demand, one of the main Ukrainian exports.

The economic evolutions of the **European Union** remain positive. The crucial role is played by a high consumption and investments demand, and the foreign demand for European exports. The commercial surplus of the euro zone hit €7.8 billion, while the main economical indicators feed the confidence in the European economy.

The **Romanian** economy continued to grow vigorously by 5.6% in the second quarter. The growth stems from the positive evolution in constructions, industry, services, and the increase of investment demand. Nevertheless, the industry practically stagnated this summer. At the same time, the managers' expectations regarding the evolution in August-October are positive for all major sectors of Romanian economy: industry, constructions, retail trade and services.

Regulatory framework

In August was published the Law on Savings and Credit Associations (SCA)¹ that starting with January 2008 will substitute the existent Law on Savings and Credit Associations of Citizens. The new law includes a set of new elements in the functioning of the Savings and Credit Associations. First of all, not only citizens (as stipulated in the present law), but the legal entities also would be able to constitute such associations. Secondly, the territorial constrains of functioning were considerably relaxed. The associations could be constituted not only on territorial grounds, but on the common interest as well. The Law has also established a set of principles of financial prudence which the associations have to comply with. At the same time, the law also contains some prohibitive regulations difficult to understand. In particular, the law prohibits the associations to render services to the third parts, including the consultancy services.

On January 1, 2008, the new Law on auditing will enter in force². Although the Parliament voted the law on March, it was promulgated in August. One of the most important provisions of this law is that public interest entities will have to annually audit their financial reports. As of public interest are considered the entities that have a special importance for the public due to their area of activity, economic dimension and the number of employees, as well as those entities that exceed the limits of 2 out of 3 following criteria: total income - 120 million lei, the balance sheet - 60 million lei, and the average number of employees – 500 persons. Besides the fact that favors the auditing companies' development, the new law will impel the companies that do not want to be considered as public interest entities with a mandatory audit, to restructure and downsize.

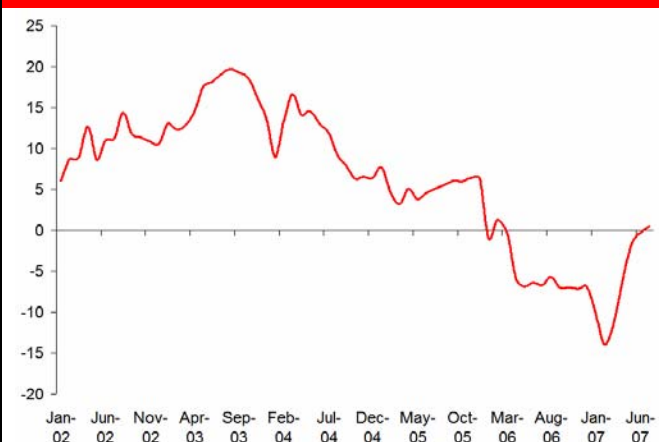
Amongst other important regulatory evolutions, in August was adopted and promulgated the Law on limited liability companies (LLC) that will enter into force on November 17, 2007. One of the most important provisions of this law is maintaining the company's minimal normative capital at the level of 5400 lei. At the draft stage, a new threshold of 30 thousand lei was proposed, the authors arguing for the necessity to remove a big number of limited liabilities companies existing only on paper. However, in order to clean register out the non-functional

commercial societies a good functioning of the insolvency law is rather required, not an increase of the minimal normative capital for LLCs. If adopted the proposed threshold, the Parliament would have made a mistake with major economic and social consequences.

Industry and constructions

According to the statistical data published by the National Bureau of Statistics (NBS), the Moldovan industry completely rode out of a recession in July and started to grow, integrally recovering the production level of January-July 2006. The real cumulative growth of the industrial output was 0.5% in the first seven months of 2007 (fig.1). At the same time, the industrial output represents only 93.8% of the volume reached in January-July 2005. This means that the pre-crisis output level was not recovered yet. The industry has to grow by 7.5% in 2007 in order to go up to the 2005 level. This will be a very hard to achieve goal in the remaining 5 months.

Figure 1 Growth of industrial output, cummulative from the beginning of 2007, %



Source: NBS

The wine and alcoholic drinks industry continue to be the main impediments for a more lively industrial growth. (In 2007 have been produced wines and alcoholic drinks by 4 and respectively, 3 times lower than in January-July 2005). On the other hand, the growth of meat processing industry speeded up as compared to the first semester of 2007 (+25%), thus, propelling the industrial sector expansion. As before, this industry benefits of a constant internal and external demand, and of the lower prices for raw material caused by the crisis in livestock sector.

¹ Law no. 139-XVI of 21 June 2007, "Monitorul Oficial" no.112-116 of 3 August 2007.

² Law no. 61-XVI of 16 March 2007, "Monitorul Oficial" no.117-126 of 10 August 2007.

Two important branches of the processing industry reduced their production growth pace in July. Thus, if in the first semester of 2007, the dairy production rose by 4.4%, than it decreased in July. Taking into account the problems with the provision of raw material, it is likely that the negative tendencies would prevail by the end of the year. Due to the drought, the producers of the processed and canned fruits and vegetables face similar difficulties in provision of a high quality raw material. In the first seven months the production of this sector was 3 times lower than in 2006; and this happened after the production rose by 17% at the beginning of 2007. It is noteworthy, that the tobacco production has also endured losses due to the low records in the agricultural sector.

Agriculture

In August the prolonged drought even more worsened the situation in agriculture, bringing about the reduction of the households' yield and increasing food expenditures of the population. According to some estimates, Moldova needs 350 thousand tons of wheat, 89 thousand tons of potatoes and 85 thousand tons of dairy products. All these products could be provided either by imports or through direct international aid. The food imports could be undermined by the decision of many countries in the region to ban or reduce the grain and other agricultural exports. The main issue regarding the more tangible international aid is the aid accumulation and distribution in a transparent and fair way, without any political biases.

As the FAO experts previously estimated after the assessment mission, the grain losses reached almost 300 million euro. Nevertheless, the losses in the livestock sector could be even higher, due to the loss of savings sources, food and income produced by the slaughtered livestock. Many farmers are almost forced into bankruptcy, and this will bring about a reduction of the seed and fodder stocks. Even the wine grapes harvest will be much lesser than that forecasted by „Moldova-Vin” Agency (560 thousand tons).

It is noteworthy, that the Ministry of Agriculture and Processing Industry did not correctly estimate the real quantity of the new wheat crop. As a result, by the end of August the prime-minister asked the Tax Office to re-estimate the quantity of wheat crop.³ This

episode shows that some agricultural “leaders” do not declare the real quantity of the new wheat crop, and do pay the taxes for land renting. Hence, the so-called “leaders” that rent or purchase tens and hundreds hectares of land and own the major part of the farm machinery, are the former “specialists” of the collective farms, which behavior did not change too much from the soviet time.

In this situation, a series of actions should be undertaken. First of all, an emergency assistance of the farmers with seed and fodder for the livestock sector is required. Secondly, it is necessary to extend the system of agriculture insurance. Thirdly, the current social protection system should be broaden out to include the population that are more likely to be considered vulnerable, because of the reduced agricultural incomes, loss of the households' savings and the rising prices for basic goods.

At the end of August, the Government made an attempt to solve the problems of agriculture by adopting the Concept on developing the viticulture and winemaking sector. This concept plans to constitute a state mortgage company, responsible for supporting the projects of planting new vineyards and purchasing machinery and fertilizers. Especially, the winegrowers would benefit by credits of almost 85 thousand lei for 1 hectare, with a reimbursement term of up to 10 years and annual interest rate of 4%. The farmers could pay back the credits after 5 years, e.g. after the first grapes harvest. Annually, credits for planting new vineyards of 2-2.5 thousand hectares would be offered. EXPERT-GRUP welcomes the concept, but it should be mirrored in a strategic document, that will include real instruments of implementation. Otherwise, nobody guarantees that after 5 years the young vineyards will harvest, because anytime are likely frosts that could jeopardize them (as happened in the last 2 years), and that the winegrowers will be able to return the loans.

In August, a German group of investors let know about its intention⁴ to initiate a long-term investment in the agricultural sector. Such intention could only inspire optimism. The German group will invest in production and processing of raw material, construction of a transport network, services, logistical activities and trade. This case could serve as an example of a sustainable agriculture development. It is noteworthy that the investors will train the agricultural workers.

³ The prime-minister Tarlev speech during the last meeting of the National Commission for Exceptional Situations Commission on 29.08.2007

⁴ Ministry of Agriculture and Processing Industry, 14.08.2007

Services

In January-July 2007, the volume of paid services rendered to the population increase by 5.9% in real terms, as compared to the similar period in 2006. At the same time, the volume of retail sales soared by 13.1% in real terms as compared to January-July 2006.

The telecommunication services registered a vigorous development in the first semester of 2007 (tab.1). The total number of the mobile telephony subscribers lifted by 27% as compared to the first semester of 2006, and reached 1.5 million. Thus, the mobile penetration rate increased by 9 points and currently registers 44.3%. Such evolutions stemmed from the substantial investments made by 3 mobile operators (270.4 million lei, by 76.3% more than in January-June 2006).

Table 1. Development of mobile telephony services in the first half of 2007

Company	Number of new subscribers, thousand	Turnover, million lei	Investments, million lei
Orange	121	755.2	184.9
Moldcell	32.3	315.3	55.6
Unite	10.9	8.7	30

Source: NBM

This evolution discloses on the one hand the intensification of competition within the sector, and on the other hand the consolidation of a monopoly situation of the company leader. At the same time, the dilution of the market concentration is imminent in the near future, especially through the new, forth operator, Eventis Mobile entering the market, and the Unite diversifying its services.

The statistical data and the rise in prices for advertisement services (35.4% in a half of year) show the rapid growth pace of the advertisement market. The rise in prices could be explained by both circumstances (recalculation of tariffs from dollar to euro base) and fundamental factors – soared demand for advertisement services by one quarter. At the present time, the main clients are the big companies with foreign capital (Efes Vitanta, Orange Moldova, Moldcell), but in the future a higher demand will emerge from the local companies as well.

On the insurance market continues the concentration of assets through big players acquiring small

companies. On august 1, the Austrian group Grawe announced the purchase of 89% share of the Insurance Company Carat, with a further increase of the share pack in the capital of purchased company.

The statistical data for the first semester shows also ascension of the tourism market, mainly tourism abroad. Although registers high growth pace, the local tourism still represents a minor segment on the market. Its development requires the improvement of the services quality and of the touristic infrastructure, that is likely only through increasing the investments into the sector.

In January-July, the transportations sector showed an ambiguous evolution. On the one hand, the volume of transported goods increased by 14%. On the other hand, the number of transported passengers declined by 7%. Due to the statistical data deficiencies, it is very difficult to estimate how much the market rose in economic terms.

Prices

As EXPERT-GRUP previously estimated, the prices continued to actively rise in the second semester; the inflation reached 2.2% in August (tab.2).

Table 2. Monthly inflation rates, %

	May 2007	June 2007	July 2007	August 2007
Index of the consumer prices	0.9	0.0	1.1	2.2
Food products	1.6	-1.3	1.6	2.2
Non-food products	0.6	0.7	1.1	0.9
Services	0.4	0.2	0.4	5.2
Index of industrial prices	0.8	0.0	0.8	

Source: NBS

Only in October 2004 a higher inflation rate was registered, while the cumulative inflation rate for 8 months of 2007 reached 7.2%. As a result of the electricity price rise, the prices for services rendered to the population increased the most. The growth of tariffs for services by 5.2% could be compared with August 2006. The food prices have also registered a rise of 2.2%, the highest one in 2007. The prices rose mainly for eggs - by 11.5%, wheat flour and bread – by 6% and 3.4% accordingly, dairy products – by 7%, and meat and meat products – by 5.9%. The drought of June-July 2007 has significantly influenced the level of prices and there are big doubts on authorities' capacity to maintain the inflation under 10%. The prices for non-food products rose by 0.9%.

Labor market

In the first semester of 2007, the economically active population constituted 1384 thousand⁵, including unemployed 58 thousand. At the same time, 36.6% (486 thousand) of the employed population worked in agriculture (including 45.8% in personal auxiliary households), and 63.4% (840 thousand) – in not-agricultural activities (by 0.95% more than in January-June 2006), particularly 12.2% worked in industry, 15.5% - in trade and hotel services, and 13.5% - in education and health. It is noticeable that the agriculture continues to prevail against industry in the number of employees. In order to increase the number of its employees, the industry requires solid investments that are likely to come in the next 2-3 years.

In January - July 2007 the salary continued to grow in real terms (+10%) as compared to 2006. In July the average salary was 2144 lei (178 USD), that was lower than in June. This decline was determined by the decrease by 19.3% of the nominal salary in the budget sector, while the nominal sector in the real sector rose by 3.2%.

The salaries' dynamics by branches shows that, as compared to June, an increase of salaries was registered in the fishery sector – by 30.3%, financial sector – by 13.2%, food industry – by 5.1% and retail sector – by 3.9%. This growth is seasonal by character.

The newly launched studies and official information on finding out new schemes of illegal emigration and human trafficking highlight the increasing negative influence of the labor force emigration on the labor market, and constitutes a high risk for the national economy. The queues to the Romania's and other states' embassies are long as never before, while the number of people asking for citizenship of other states is growing too. The Socio-political Barometer presented by the survey service Omnimas found out that 62% of respondents would accept to go abroad for earning money, including 20% forever, if would have such an opportunity.

Budget

In August, a set of important legislative acts related to the budgetary sphere were published: the annual Report on State Budget execution for 2006⁶, the Decision on approving the Report on management of

public finances in the budgetary year 2006, the Decision on the report on creating and executing the state social insurance budget revenues for 2006, and the Decision on the report regarding the control's results on collecting and executing the mandatory medical assistance insurance funds' revenues for 2006. Thus, the public financial resources were collected and executed as follows:

- **State budget.** Due to the State Tax Service and the Customs Service, the state budget revenues were collected in proportion of 101.8% of the planned level. On the other hand, the expenditures were executed in proportion of 97.7% of the planned level, and brought about a surplus of 98.1 million lei against the expected deficit of 334.6 million lei. The highest amount of the unused financial resources were registered at Customs Service, Ministry of Agriculture and Processing Industry, Ministry of Foreign Affairs and European Integration, SC "Moldova-Gaz", Ministry of Education and Youth, Ministry of Interior. Some irregularities in executing the special funds were found out as well. Namely, the Road Fund and the Fund for subsidizing the agricultural producers earmarked the major part of subsidies at the end of year.
- **The State Social Insurance Budget (SSIB)** revenues were collected at the level of 99.1%, while the expenditures were executed at the level of 99.8%. The revenue deficit was caused by the decline in the number of taxpayers. Although the total expenditures were executed under the planned level, the expenditures of the Pension Fund, Indemnity Fund and the Insurance Fund for Labour Accidents and Professional Diseases exceeded the planned level. Considering the current demographical trends and that the expenditures for paying pensions represents 71.8% of total SSIB expenditures, it is obvious that the public social insurance system is endangered. The financial durability of SSIB could be insured only by changes in the existing pension and social assistance systems.
- The revenues to the **Compulsory Medical Assistance Insurance Fund** were collected in proportion of 102% due to the average salary rise. Nevertheless, the allowances from the state budget continue to grow, counting for 64% of total revenues, while the insurance premiums paid by physical persons were collected at the level of 64.1% of the planned one.

⁵ The labor force in the Republic of Moldova: occupation and the unemployment in the 2nd quarter of 2007, NBS.

⁶ Monitorul Oficial of 10.08.2007

- The audit of the budgets of Chisinau municipality, Gagauzian autonomy and 14 districts, found out that the local authorities' underestimation of their own revenues on the planning stage has a negative consequence on realization of the **local budgets**. As a result, the revenues were realized in proportion of 102.6% and the expenditures were executed at 95.5% of the planed level. Only in Gagauzia and 7 districts the realized revenues were smaller than planned.

On August 24, the Ministry of Finances brought in to the Government the Draft 2008 State Budget Law, with revenues of 14458.0 million lei and expenditures of 14681.7 million lei. The draft law was drawn up on optimistic assumptions. Among other things, it anticipates an output growth of 7%, an inflation rate of 9.3% and exports and imports to increase by 15%. There are significant differences between main macroeconomic indicators set down in the 2008 State Budget Law and the Medium Term Expenditure Framework (MTEF) for 2008-2011. For instance, the latter expects an output growth of 5% and an inflation rate of 8% for 2008. Another difference relates to the annual increase of public budget expenditures; the 2008 State Budget Law anticipates them to grow by 1.6% as compared to 2007, while MTEF by 2%.

At the same time, Moldova expects to receive foreign grants worth 1 billion lei in 2008. According to the draft budget, the main donors supporting the budget will be the European Commission, the Dutch and British governments, and supporting the investment projects – the World Bank, the Global Fund to Fight AIDS, Tuberculosis and Malaria and the Swedish International Development Agency (SIDA).

Table 3. Dynamics of the national public budget

	Planned M1-M7/07	Executed M1-M7/07	Executed M1-M7/06
Global revenues, million MDL	11119.4	11676.9	9222.1
Including revenues from VAT, million MDL	3938.3	3945.1	3046.2
Including income taxes from business activity	702.4	918.9	844.8
Global expenditures, million MDL	13874	11824.2	9199.7

Source: NBMS

With regard to the 2007 budget execution, in January – August, 99.9% of the planned revenues and 86.2% of the planned expenditures were realized. The realization of public budget expenditures also increased. Thus, in January-July 2007, the expenditures were realized at 85.2% level of the planned one, and the revenues at 105%. (tab. 3)

Nevertheless, the realization of expenditures still remains at a low level. As a result, being discontent with the public finances management, the Ministry of Finances decided to suspend the access to finances unused by budget executors, excepting the funds for capital investments and repairs⁷.

On August 22, at the Government meeting, the minister of Economy and Trade, Igor Dodon presented a report on implementation of the Law on economy liberalization no. 111-XVI of April 27, 2007. Since the law enactment until August, the State Tax Service cancelled the arrears to the state budget of 32,065 taxpayers or, a quantum of 3.992 billion lei. Of this sum, the basic payments constituted 1270.9 million lei, the penalties - 1048.8 million lei and the fines 779.5 million lei. The arrears of 7029 taxpayers to the mandatory medical assistance insurance funds counting 8.3 million lei were annulled too. The National Social Insurance House also cancelled the arrears accrued to the state social insurance budget for districts and for the whole republic, summing up 947.88 million lei, consisting of the contributions owed by the employers - 514.35 million lei, the individual contributions - 221.06 million lei and penalties and fines – 212.47 million lei.

The capital and financial means legalization has carried out slower than the fiscal amnesty. For the moment, first cases of assets legalization have been registered. The value of assets exceeded 7 million lei. By August 11, only 2 physical persons and 1 legal entity legalized their capital. On the other hand, the capital and financial means legalization concludes at the end of 2008, and the other countries' experience shows that such kind of actions intensify as the deadline is getting closer.

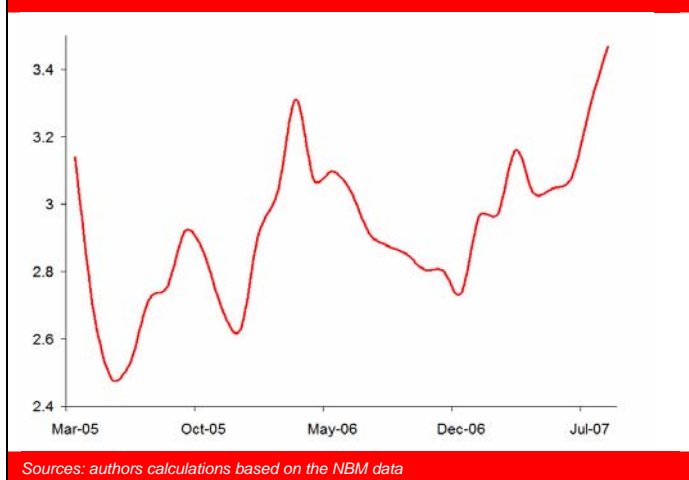
Money

No essential changes occurred in the monetary policy in August. The NBM Council of Administration did not modify the Bank monetary policy instruments. As the NBM found out on August 8, 2007 in its press release "in order to ensure the irreversibility of the

⁷ Decision on suspending the access to the unused budget finances for 2007, no.907 of 09.08.2007.

inflation rate reduction, the National Bank Council of Administration decided to maintain the NBM base rate applied at the banks' refinancing through 2-month state securities REPO-buying operations at the annual level of 13.5%". At the same time, this press release discloses the NBM concerns regarding the fact that "a slower pace of inflation reduction recorded in 2nd quarter proves that some inflationary expectations persist". This collocation leaves room for a slight increase of the NBM rate in the next future.

Figure 2 Imports coverage by official reserves assets, imports by months



It is noteworthy the continuing growth of official reserve assets, which surpassed the threshold of 1 billion USD. Despite the rapid growth of imports, it could be noticed their broader coverage by the official reserve assets (fig.2). The strengthening of the national currency has favored even more the imports' growth along with the consolidation of the NBM foreign currency reserves.

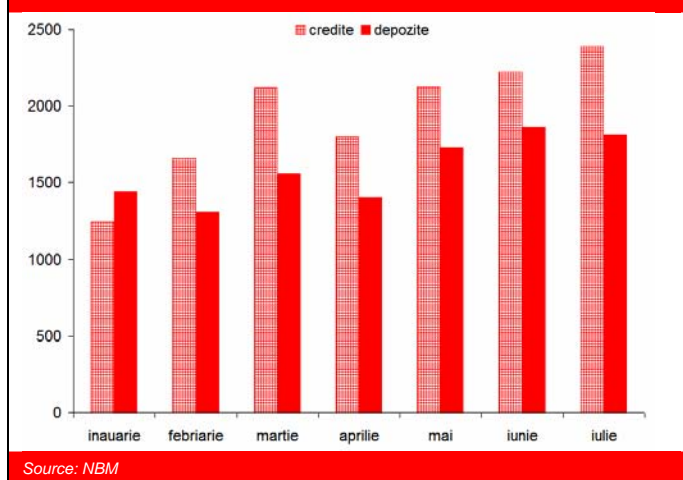
On the other hand, the official statistical data indicate the speeding up of prices rise in August (2.2%). This fact sustains our concerns expressed in previous BER edition that the worst scenario of the economy evolution could be outlined, namely when the appreciation of the national currency goes along with the rise in prices on the internal market. Such evolution could erode the purchase power of a significant segment of the population that depends on the emigrants' foreign currency remittances.

Banking system

After the continuing increase of interest rates for the credits granted by commercial banks during the second quarter of 2007, in July the average interest

rate fell to 18.82% on credits given in national currency and to 10.81% on credits given in foreign currency. At the same time, the average interest rate on the attracted deposits increased to 15.50% and 6.05% respectively. The growth of interest rate for deposits was conditioned by two factors: the population's inflationary expectations because of the June-July drought, and the relatively low level of attracted deposits in July. However, this can also generate the growth of the interest rate on credits to be contracted in the following months.

Figure 3 Evolution of credits and deposits in the banking system, million lei



In July the contracted credits reached the 2007 highest level of 2389.5 million lei, while 50% of them are the credits in foreign currency. The monthly evolution of contracted credits and attracted deposits is represented in Figure 3. The demand for mortgage credits and "capital repairs" credits continue to grow, despite the increasing prices on the real estate market.

The share of foreign investments in local banks' capital reached 65.12% in July. The boost of foreign investments in Moldovan banks during 2007 mainly results from the share increase of the French group Societe Generale in the shareholders' capital of Mobiasbanca up to 95%, and from the investment of Eximbank's income in the bank development. On 9 August the Shareholders General Assembly of Eximbank decided to increase the bank's normative capital by 250 thousand lei. This is the third increase in normative capital since the Italian Group Veneto Banca bought 100% of Eximbank in May 2006, and reveals serious and long-term intentions of the Italian bank.

Hence, the increase of foreign investors' share in the capital of Moldovan banks is further expected. Moreover, during the Shareholders General Assembly of Petromservice on September 18, the possibility for purchasing an important share of a Moldovan bank was discussed. The name of the bank in which Petromservice is interested has not been made public yet.

In August the National Bank of Moldova approved and published a set of 10 decisions regarding the risk management in banking activity that in fact complete and amend the already existing documents. Only the Resolution regarding the supervision of the Automated Interbank Payments System is a new document that will enter in force from January 1, 2008, even though many of its provisions have been already executed. The Resolution contains provisions on the management of liquidity risk and operational risk.

Since the operational risks occur less frequently at technical level, the establishment of certain requirements for liquidity in the banking system in accordance with Basel II recommendations is welcomed; as according to the 1st principle of liquidity the rate between assets and financial resources, both with a maturity exceeding 2 years, has grown within the banking system during the last year, while according to the 2nd principle the rate between the liquid assets and total assets has decreased.

Financial markets

In August the interest rate on T-Bonds continued to decline. The interest rate on bonds with maturity of 91 days fell from 11.08% in July to 10.84% in August. The interest rate on bonds with maturity of 182 and 364 days decreased less. The interest rate decrease in condition of a speeding up inflation reveals the decline of T-bonds profitability that will reduce the commercial banks' interest for this bonds in the near future. At the moment the demand is still maintained at high levels.

In August the Moldovan Leu continued to appreciate against the US dollar and euro. From 12.10 MDL/USD at the beginning of August, the exchange rate reached 11.96 MDL/USD on August 23. The determinant factors for the Moldovan Leu appreciation remain the same: the foreign currency inflows from physical persons, higher foreign investments, greater inflow of bi- and multilateral official aid. The continuing appreciation of the Russian ruble against the US dollar has also contributed to the national currency appreciation.

Foreign trade

In July the trade deficit continued to widen. In January-July 2007 it reached the record high level of 1.2 billion USD, which is 42.1% more than in the same period of 2006. At the same time, in this period the exports worth reaches only 703.6 million dollars. Obviously, the coverage degree of imports by exports sank from 39.1% in January-July 2006 to 37% in January-July 2007. If the current increase in trade deficit persists, it is reasonable to expect that the trade deficit will be twice greater than the exports worth by the end of the year.

The widening of the trade deficit stems from an already „traditional” trend for Moldova; namely the dramatic boost of imports in condition of rather modest increase of exports. This tendency results from the combination of several factors. The high internal demand supplied by emigrants' remittances, along with the incapacity of Moldovan companies to respond to this demand determines the rapid rise of imports. Moldovan exports are still based on low added value products that face the harshest competitive pressures on the sales markets. The recent changes in the export structure, namely the promotion of textiles at the expense of agro-alimentary products do not give good reasons for enthusiasm. These exports are based on imported raw material and in any case have a reduced technological input. At the same time, we believe that these structural changes will increase in the near future, as the compression of agro-alimentary exports seems to be durable (see also BER 22). Also, the textile exports will increase, besides other things due to the movement of production capacities from the new EU member states further to the East.

The resumption of Moldovan wine exports to Russian market remains uncertain; correspondingly to the skeptical expectations of EXPERT-GRUP stated when this “drama” started. In August a delegation from “Rospotrebnadzor” visited Moldova to inspect the level in which the Moldovan wine companies respect the technological and sanitary requirements of this agency. It seems that the inspectors from “Rospotrebnadzor” were rather unsatisfied with some of the companies, implying that the “massive” resuming of exports is under question again. This provoked live reactions of “Moldova-Vin” Agency and even of Moldovan President. The motto of these reactions was the following: “Either everybody, or nobody. “Rospotrebnadzor” inspections are tendentious and in fact, illegitimate.” The Russian Agency's response followed shortly: “One more visit of Russian experts is needed”. Neither the visit of

Gherman Gref, the Russian Minister of Economic Development and Trade, has clarified the situation. At the Moldovan journalists' questions regarding exports resumption, the Russian minister answered with the standard expression "Moldovan champagne on Russians' New Year's Table" and also considered President Voronin's declarations as an incentive for "improving the efficiency and promptness of Rospotrebnadzor". As before, this visit did not produce any major agreement concerning the economic relations between Moldova and Russia... at least not publicly. We believe that the "wine problem" still remains a hostage of the "political dialogue" between Moldova and Russia.

It is noteworthy that this issue is about to become a fetish for Moldovan politicians. The fact that the Moldovan president exchanges replies with a 2nd rank Russian clerk as the leader of "Rospotrebnadzor" is, only confirms this hypothesis. Yet, at a practical level the resumption of wine exports to Russian market is not a "necessary and sufficient" solution for the problems of Moldovan wine sector, as these problems have mainly internal roots. The Moldovan wine companies will not be able to conquer great quotas on the Russian market and therefore, it is better that only the most competitive companies able to produce worldwide competitive wines remain.

Global markets

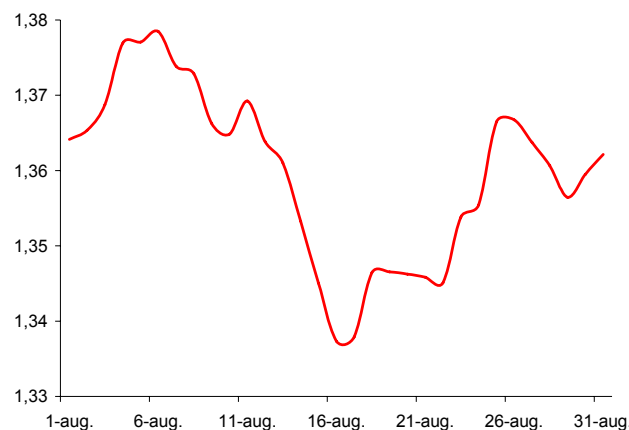
In August the **oil** price lowered. However, this price correction was mainly molded by the turbulences on the global capital markets. The liquidity "crisis" felt on a global scale caused massive sales of assets, while the gloomy expectations on American economy prospects, the main oil importer, determined the oil price decrease at 70 USD/barrel Brent brand. On the contrary, by the end of August and beginning of September an opposite trend occurred and the oil price rose to 75 USD/barrel.

This evolution was essentially caused by the bad weather conditions in Mexican Gulf, where many capacities for oil extraction are located, as well as by the considerable reduction in reserves of oil derivatives in the United States. At the same time, OPEC remains reticent towards increasing the volume of oil extraction, estimating that the rise of oil price is rather caused by insufficient oil processing capacities, not by insufficient petroleum supply⁸.

In August the forecasts for **wheat** crop 07/08 were negatively modified. The crop was negatively affected by unfavorable weather conditions in the northern hemisphere, but also in Australia, because of strong winds. Hence, the crop in Australia is expected to be reduced by several million tones. An eventual restriction on the wheat exports from Russia, which lately is more frequently discussed, could determine a new jump in prices. Even if the forecasts of consumption also show decrease, it is expected that the final stocks will reach the historical lows from 1979-80 onwards, 111 million tones approximately. Because of the limited supply, the situation on the **barley** market remains tensioned, while the prices lift⁹.

Generally, in August 2007 the dollar-euro fluctuations were modest (Figure 4), being mainly influenced by unfavorable evolutions on the American real estate market and by the „liquidity crisis" on global markets that pressured the stability of global financial architecture. Moreover, at the beginning of September the Organization for Economic Cooperation and Development mentioned that the prospects for economic growth „are clearly less optimistic and more uncertain" than in May 2007.

Figure 4 Evolution of exchange rate USD/EUR



Source: Rosbusinessconsulting

Thus, during the first half of August the tendency of exchange rate correction and dollar's strengthening against other currencies was noticed. By the middle of August this tendency was determined by turbulences on global financial markets stemmed from difficult situation on the real estate market (*subprime* mortgage credits). In conditions of

⁹ Source: USDA, World Agricultural Supply and Demand Estimates, Wheat Outlook; International Grains Council, Grain Market Report; The Financial Times.

⁸ Source: The Economist, International Energy Agency, Reuters, RBC.

increased turbulences the dollar is usually considered a safe investment, which determined a slight increase of this currency up to 1.34\$/€. This tendency was also sustained by positive data concerning the economic situation of the United States (the increase in retail sales, the increase of labor productivity and the reduction of commercial deficit).

Still, by the end of August, the dollar sank at 1.36-1.365 \$/€. This decline was determined by the broader recognition of risks for the USA economic development caused by the crisis on the real estate market. It was also determined by the very optimistic statistical data from the Euro zone (industry growth, unemployment reduction, business and consumers' confidence) that gives optimistic prospects of growth in the 3rd quarter¹⁰.

Trade partners

The Russian economy remained on an ascending path in July 2007. In January-July 2007 the Russian economy grew by 7.9%, as compared to the similar period of 2006. Likewise in the first half of 2007, this growth was driven by a strong investment demand (+22.7% in January-July 2007 as compare to 2006), the expanding dynamics of construction sector (+25.4%) and that of industry (+7.7%). In July the industry expansion was greatly determined by the growth of investment-demanding branches: constructions and automobile construction. The consumption also contributed to the economic growth. It resulted from the real income of the population and from the real wage that grew by 11.9% and by 17.1%, respectively. The robustness of current consumption led to the lift of retail trade (+14.2%). However, because of petroleum price fall and of Russian ruble reinforcement, the growth of exports remains modest (9.7%). By contrary, due to the expanding demand for consumption and investments, as well as due to the ruble reinforcement the imports increased by 37.3%.

The so-called "liquidity crisis" (see **Global Markets**) impose serious risks for several emergent big economies that have developed lately in a very speedy way, Russia being one of them. The statistical data prove an increasing dependence of Russian banks and corporate sector on the external credit sources. Hence, their external debts soared by 70% between January 2006 and June 2007, or from 4% to 6% of Russian GDP. The August turbulences on financial markets have already determined several big Russian companies to modify their plans

regarding the investment of Eurobonds. If the turbulences continue in autumn (as the majority of pundits predict) the Russian banks and corporations could end up at the situation of limited access to foreign credits, also having to face harder conditions of servicing the already contracted credits. Moreover, a possible broad crisis would also negatively affect the prospects of global economic growth and implicitly, the raw material demand, representing one of the main Russian exports. Obviously, such an evolution can have a considerable impact both on the electoral agenda during the parliamentary and presidential campaigns and on the future Russian president's policy agenda¹¹.

In January-July 2007 the **Ukrainian** economy continued to grow vigorously, reaching the level of +7.9%, comparing to the similar period of 2006. Besides the private consumption increase (+28%) and the exports' growth (+28.6%), constructions have an important contribution (+14.5%) too. The commercial deficit continued to grow and reached the level of 2.34 billion USD or 3.6% of GDP in January-July 2007. Exports and imports expanded considerably, by +28.6% and +32.9% respectively.

Table 4. Economic indicators of Moldova's main trade partners

	GDP		Industrial output	Inflation,	Unemployment
	Last data	2007, forecasts			
Russia	7.9 01-07/07	6.5	7.7 01-07/07	6.6 01-07/07	5.8 07/2007
Ukraine	7.2 01-07/07	7.5	7.8 01-07/07	5.6 01-07/07	8.0 Q1/2007
Romania	5.8 Q2/07	6.5	6.3 01-07/07	4.1 07/07	6.9 07/07
Germany	2.5 Q2/07	2.2	5.7 06/07	2.0 07/07	6.4 07/07
Italia	1.8 Q2/07	1.7	-0.1 06/07	1.7 07/07	6.1 Q1, 2007

Sources: The Economist, IMF, Eorid Bank, Derjkomstat, Goskomstat, Eurostat, INS România, EXPERT-GRUP

The growth in exports was supported by favorable circumstances for metal prices, the demand for machinery and equipment made in Ukraine and by commercialization of Ukrainian agricultural products. However, the exports' growth could slowdown in the near future. On July 1, the Ukrainian government introduced restrictions on certain grain exports. Moreover, the turbulences on financial markets

¹⁰ Reuters, RBC, Global Insight Inc., OECD, The Financial Times.

¹¹ The Ministry of Commerce and Economic Development, The Institute of Transitional Economy.

reduce the likelihood of a global economic growth, which besides other things can imply the reduction of demand for raw materials, including metals, one of the main Ukrainian exports¹².

In the **European Union** the economic prospects remain optimistic. Despite the limited output growth of the Euro zone during the first quarter, most analysts consider the prospects of the European economy to be good. Indeed, the fundamental economic indices – the increase of industrial orders, the augmentation of corporate and consumers' confidence, an improved situation on the labor market – demonstrate that the internal demand will supply the economic growth during the second half of 2007 as well. Moreover, the industry is also greatly supported by the external demand (the commercial surplus grew in July 2006 up to €7.8 billion) that currently seems to be little affected by the demand compression in the United States and by the appreciation of the European currency. The inflation is under control at the moment (1.8%¹³), which made it possible for the European Central Bank not rise the interest rate in August, although several experts think that this is a step to be undertaken in September¹⁴.

In the second quarter of 2007 the **Romanian** economy in Romania grew by 5.6%. This growth stems from the positive evolution in constructions (+30.1% in January–July 2007 as compared to the similar period of 2006) and in industry (+6.3%, although the industry practically stagnated this summer). The growth also results from the increase of investment demand (17.8% during the first quarter of 2007). It is noteworthy that a little more than half of these investments are directed to constructions. The evolutions on the labor market and the growth of real salaries (+23.5%) support the expansion of retail trade (+11.8%). At the same time, the managers' expectations regarding the evolution in August–October are positive for all major sectors of Romanian economy: industry, constructions, retail trade and services. Yet, the prospects for new jobs in industry are rather poor and the rise in prices is anticipated for all these sectors¹⁵.



¹² Institute for Economic Research and Policy Consulting, International Centre for Policy Studies, Expert-Ukraine.

¹³ The inflation target established by The European Central Bank is 2%.

¹⁴ Eurostat, The Economist, RBC, Global Insight Inc.

¹⁵ Sources: Săptămâna Financiară (Financial Week), Capital (The Capital), Curentul, The Economist